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FM AMEMBASSY JAKARTA

TO RUEHC/SECSTATE WASHDC 1025

RUEATRS/DEPT OF TREASURY WASHINGTON DC

INFO RUEHZS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS

RUCPDOC/DEPT OF COMMERCE WASHINGTON DC

RUEHRC/DEPT OF AGRICULTURE WASHINGTON DC

RUEHKO/AMEMBASSY TOKYO 2874

RUEHBJ/AMEMBASSY BEIJING 5756

RUEHBY/AMEMBASSY CANBERRA 3434

RUEHUL/AMEMBASSY SEOUL 5253

RUEHGP/AMEMBASSY SINGAPORE 6405

RUEAIIA/CIA WASHDC

UNCLAS SECTION 01 OF 02 JAKARTA 002300

SIPDIS
SENSITIVE

DEPT FOR EAP/MTS, EAP/EP AND EEB/IFD/OMA
TREASURY FOR IA/MALACHY NUGENT AND TRINA RAND
COMMERCE FOR 4430/KELLY
DEPT PASS FEDERAL RESERVE SAN FRANCISCO FOR CURRAN
DEPARTMENT PASS EXIM BANK
SINGAPORE FOR SBAKER
TOKYO FOR MGREWE
USDA/FAS/OA YOST, MILLER, JACKSON
USDA/FAS/OCRA CRIKER, HIGGISTON, RADLER
USDA/FAS/OGA CHAUDRY, DWYER
DEPT PASS USTR WEISEL, EHLERS

E.O. 12598: N/A

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SUBJECT: IMF AND WORLD BANK CAUTIOUSLY OPTIMISTIC ABOUT INDONESIAN ECONOMY

¶1. (SBU) Summary. The IMF resident representative and World Bank country director are cautiously optimistic about Indonesia's ability to manage the economic impact of the global financial crisis. In a December 18 lunch hosted by Ambassador Hume, World Bank country director Joachim von Amsberg and IMF resident representative Milan Zavadil cited Indonesia's strong economic team, sound macroeconomic policies, healthy banking system, and large domestic economy as key factors in Indonesia's ability to absorb the global downturn. They warned, however, that the global crisis is likely to intensify in 2009, leading to increased unemployment in Indonesia and putting additional stress on the banking and corporate sectors. Indonesia's ability to deal quickly and effectively with emerging cases of corporate or bank failure will be critical to maintaining investor confidence, according to IMF Resident Representative Zavadil. The World Bank is considering significantly increasing its assistance to Indonesia. End Summary.

Indonesia in Strong Position to Weather Crisis

¶2. (SBU) Indonesia is in a stronger position than most emerging market economies to deal with the impact of the global financial crisis, according to von Amsberg and Zavadil. Indonesia's economic team, led by Coordinating Minister for the Economy Sir Mulyani Indrawati, recognized the need to secure financing for the 2009 budget early on in the global financial crisis. Under Minister Mulyani's leadership, Indonesia was one of a small number of countries that sought budget support from the World Bank prior to the onset of serious domestic economic distress. Indonesia also had low public debt levels entering the crisis due to the fiscal prudence of the economic team, giving it the flexibility to conduct countercyclical fiscal policy.

¶3. (SBU) The representatives generally lauded the Government of Indonesia's (GOI) macroeconomic response to the crisis, citing their injection of liquidity into the banking system, decision to reduce intervention in the foreign exchange markets as reserves began to fall too rapidly, and measured approach to monetary easing. The strength of Indonesia's large banks will also help support the

country as global demand for Indonesian products falls, according to both institutions. Preliminary data for October 2008 indicate steady and low nonperforming loan levels, strong net interest margins and continued strong credit growth, according to Zavadjil. The representatives also cited the large size of Indonesia's domestic economy and the current robust level of domestic demand as key factors softening the impact of flagging export growth.

Downside Risks to Test Government

¶4. (SBU) Despite Indonesia's strong economic foundations, both institutions expect the impact of the global financial crisis on the Indonesian economy to intensify in the next six months. Zavadjil noted that there is a significant shift in deposits from smaller to larger banks, putting pressure on the small bank sector. Although small bank failures are unlikely to cause an immediate systemic banking collapse, he warned that the mishandling of bank failures could spark a collapse in depositor confidence. Both representatives also speculated that a series of corporate failures involving well-connected Indonesians that the GOI fails to resolve in a transparent manner would trigger another wave of international investor retreat from Indonesia. Zavadjil also noted that the size and trading volumes of Indonesian equity, bond and currency markets have fallen significantly, allowing one or two large market players to have a significant impact on prices.

¶5. (SBU) Both institutions expect growth to slow considerably in 2009, but neither envisions massive capital flight or a balance of payments crisis. They noted that they personally believe that their respective institutions' growth forecasts for 2009, 4.4% (World Bank) and 5.5% (IMF), are overly optimistic. Their outlook for

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unemployment and wages in Indonesia has also deteriorated in recent weeks, as global demand for Indonesian products continues to slump. Recent press reports that neighboring countries are returning large numbers of Indonesian workers will also exacerbate the unemployment picture in 2009.

World Bank Evaluating Large Increase in Assistance

¶6. (SBU) World Bank Country Director Joachim von Amsberg noted that his institution is evaluating a significant increasing in its assistance to Indonesia. The World Bank believes that its assistance can make a major impact in Indonesia because of the government's commitment to economic reform and the strategic importance of the country. Indonesia is one of a small number of countries that the bank is considering for the large increase in funding.

HUME